

BEFORE THE STATE TAX APPEAL BOARD  
OF THE STATE OF MONTANA

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RONALD L. AND LAUREEN H. MASHEK,	)	DOCKET NO.: IT-1997-5
Appellants,	)	
	)	
-vs-	)	
	)	
THE DEPARTMENT OF REVENUE	)	FINDINGS OF FACT,
OF THE STATE OF MONTANA,	)	CONCLUSIONS OF LAW,
	)	ORDER and OPPORTUNITY
Respondent.	)	<u>FOR JUDICIAL REVIEW</u>

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The above-entitled appeal was heard on the 12th day of January, 1998 in Helena, Montana in accordance with the order of the State Tax Appeal Board of the State of Montana (the Board). The notice of the hearing was given as required by law.

Ronald L. Mashek, taxpayer, presented testimony in support of the appeal. The Department of Revenue (DOR), represented by Exam Bureau Chief Robert A. Turner and Compliance Officer David Olsen, presented testimony in opposition to the appeal. Testimony was presented and exhibits were received.

The Board then took the appeal under advisement; and the Board, having fully considered the testimony, exhibits, and all things and matters presented to it by all parties, finds and concludes as follows:

### **STATEMENT OF THE ISSUE**

The taxpayers, RONALD L. and LAUREEN H. MASHEK, are appealing the Final Agency Decision of the DOR which upheld the assessment of taxes owing for 1994, 1995, and 1996 as ordered. At issue is how Voluntary Separation Incentive (VSI) payments should be treated under the Montana Military Exemption, §15-30-116 MCA.

### **FINDINGS OF FACT**

1. Due, proper, and sufficient notice was given of this matter and of the time and place of the hearing. All parties were afforded the opportunity to present evidence, oral and documentary.

2. Ronald Mashek was released from active duty in the Military Police Corps in 1994. He was separated from active duty and reassigned to the United States Army Reserve Control Group on an "on-call" basis pursuant to the Voluntary Separation Incentive (VSI) Program. Under the VSI plan, he entered into a contract in which he agreed to remain on-call for possible active duty for 29 years. In return he was to receive annual VSI payments for that length of time.

3. As a result of a routine examination of the taxpayers' 1996 Montana Individual Income Tax return, an error

resolution work sheet was generated, triggered by the fact that the return was flagged by the Compliance Section due to a previous incident of non-filing while Mr. Mashek had been on bona fide active duty. The return and error sheet prompted a DOR Tax Examiner in the Compliance Section to request additional information in connection with the military exemption claimed on the return, to include information that wages earned in 1995 and 1996 had been earned under Title 10 and active duty.

4. The taxpayer, Mr. Mashek, advised the DOR that his VSI payments had not been received while on active duty. He asserted, however, that he had been informed by the DOR that such payments, paid under Title 10, U.S.C.A., were exempt from state income tax.

5. The taxpayers' 1994, 1995, and 1996 Montana Individual Income Tax returns were adjusted to include the VSI payments in adjusted gross income for those years. The Notice of Assessment dated March 17, 1997, income tax due was assessed in the amounts of \$405.00, \$962.44, and \$1,222.00, respectively. Penalty and interest amounts were also assessed for taxable years 1994 and 1995 in the amounts of \$110.20 and \$175.03, respectively, for a total balance due of \$2,874.67.

6. In a meeting with DOR personnel, the taxpayer requested the assessments for 1994 and 1995 be abated; he had been given to understand that payments made under authority of Title 10 were exempt with no other qualifications or conditions.

7. In a letter of April 19, 1997, the taxpayer requested a department hearing and that hearing was held on June 20, 1997. A decision was rendered on July 31, 1997 and stated, in part:

...."active duty" is clearly a requisite element of the state exemption, and for the time he has received the VSI payments Mr. Mashek has not been on "active duty" as that term is defined under 10 U.S.C.A. §101(22). He has been, and continues to be, on an on-call status. However, that status simply does not qualify him under the clear and plain terms of §15-30-116(2), MCA. The Department's adjustments were correct.

While the lack of any reference to the active duty requirement in the tax booklets or on the part of agency personnel can thus be explained, such omissions were still wrong as a matter of law. The existence of the requirement should have been raised. Thus, it seems entirely appropriate to invoke ARM 42.3.105(5)(b) to waive the penalties and interest assessed against the Taxpayer in this case. Unfortunately, that authority simply does not extend to the tax itself. The Hearing Examiner has absolutely no choice but to render a decision accordingly.

8. The taxpayer appealed that decision to the

Department Director, who issued a Final Agency Decision on October 23, 1997, concurring with the Hearing Examiner's decision.

9. An appeal from the Final Agency Decision was received from the taxpayer by this Board on October 29, 1997.

#### **TAXPAYERS' CONTENTIONS**

Through exhibits and testimony, Mr. Mashek, the taxpayer, chronicled his experiences with the DOR and his frustrations which resulted from the contradictory nature of information and direction he received from the DOR and from the Department of Defense.

The taxpayer stated he had done nothing wrong and had made a significant effort to file and pay his taxes in accordance with Montana law. He stated he had been misinformed by the DOR that, as the payments were made under the authority of Title 10, U.S.C.A., VSI payments were exempt from state income tax.

The taxpayer stated that the tax preparation instruction materials contained erroneous and incomplete information. He pointed out that instructions given in materials for preparation of the Montana Individual Income Tax Returns for 1994 and 1995 were identical in that each stated

"Military pay earned as a result of service performed under the authority of USC Title 10 is exempt from Montana taxation." The 1996 instructions added the provision that it was necessary to provide verification of service under Title 10 and also stated: "Separation pay is not considered wages. As such separation pay is fully taxable on your state return." He asserted that VSI payments were not deemed to be classified as separation pay and might better be described as a retainer; and they are paid out of active duty funds.

#### **DEPARTMENT OF REVENUE'S CONTENTIONS**

The DOR submitted a copy of §15-30-116(2) MCA. which provides that income is exempt from taxation under the income tax laws of the state of Montana only if one is "....serving on active duty in the regular Armed Forces...." Also submitted was a copy of the applicable administrative rule, ARM 42.15.111(2)(3) which provides that "....compensation for active duty service as a member of the regular Armed Forces is exempt from tax." and "Residents will be considered members of the Armed Forces on active duty when they are called to duty under Title 10 U.S.C.A." (DOR Ex A-1)

The DOR testified its legal department had determined the payments to the taxpayer under the VSI program were not

exempt since he is not on active duty. This information was communicated to the taxpayer in a letter of April 25, 1997 (DOR Ex A-4)

In that same letter the DOR offered to abate the interest and penalties for tax years 1994, 1995, and 1996. In a subsequent letter, January 7, 1998, the DOR offered a 12 month payment plan for the taxes owed for the three tax years involved. Citing the Taxpayer Bill of Rights, the DOR stated it is allowed to waive the interest and penalties if a taxpayer has received incorrect information from an employee of the Department. The letter pointed out that it would indeed waive the interest and penalties but that this waiver does not extend to taxes due and owing.

#### **DISCUSSION**

This Board concurs with the Memorandum Opinion of the Hearing Examiner that the frustrations the taxpayer developed in his attempt to obtain accurate information in order to file and pay his taxes in compliance with the law were understandable. There is also concurrence that a decision of the exemption of VSI payments is, quite obviously, bound by the law.

The taxpayer did, indeed, receive conflicting

information, both from the Department of Defense and from the Montana Department of Revenue; however, the controlling statute does state that earnings that are exempt from state income tax are earnings received from the armed forces by residents who are serving on active duty in the regular armed forces. The administrative rules defines active duty as those residents who are called to duty under Title 10, U.S.C.A. The active duty requirement must be met before the exemption can apply. In the case of the taxpayer, he is not on active duty; on call, perhaps, but not on active duty.

Tax instruction information supplied to taxpayers, whether through instruction booklets or DOR personnel should accurately describe the laws and procedures required. The omission of this accurate information is unfortunate, but of course the law supersedes the inaccurate information.

This Board, therefore, concurs with the Final Agency Decision of the DOR which supported the Opinion and Order of the Hearing Examiner: that the DOR assessment of taxes is due and owing and that the penalty and interest amounts for the three years in question be waived.

#### **CONCLUSIONS OF LAW**



1. The State Tax Appeal Board has jurisdiction over this matter. §15-2-302 MCA

2. Salary received by Montana residents who are serving on active duty in the regular armed forces and who entered into active duty from Montana is exempt from state income tax. §15-30-116(2) MCA

3. Effective with taxable years ending after December 31, 1974, compensation for active duty service to a Montana resident as a member of the regular Armed Forces is exempt from tax. Residents are considered members of the Armed Forces on active duty when they are called to duty under Title 10, U.S.C.A. Montana National Guard members and others serving under another authority are subject to the tax. ARM 42.15.111(2)(3)

4. If, in the opinion of the Department, a taxpayer's return is incorrect in any essential respect it may revise the return based upon any information then available to it. §15-30-145(1) MCA

5. The Department may abate or waive penalties if a taxpayer can establish that his or her failure to file or pay timely was due to reasonable cause and not to neglect on his or her part. §15-30-321(1) MCA

6. Examples of "reasonable cause" for failure to file a return or pay a tax on the date required by statute include substantiation that the delay or failure was due to erroneous information provided the taxpayer by an employee of the Department of Revenue. ARM 42.3.105(5)(b)

7. The Department shall not waive a duly assessed tax. ARM 42.3.112

**ORDER**

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the assessment of taxes owing for tax years 1994, 1995, and 1996 as determined by the Department of Revenue is properly due and owing by the taxpayers. It is further ordered that the late pay penalties and interest amounts for tax years 1994 and 1995 be waived.

Dated this 9th day of February, 1998.

BY ORDER OF THE  
STATE TAX APPEAL BOARD

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PATRICK E. McKELVEY, Chairman

( S E A L )

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GREGORY A. THORNQUIST, Member

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LINDA L. VAUGHEY, Member

NOTICE: You are entitled to judicial review of this Order in accordance with Section 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.

